# To Our New Subscribers

**Thank you to our new subscribers and welcome to the third issue of the ARM quarterly newsletter! We hope to make this publication valuable to you with several brief articles that provide unique insights, some ideas about how to address specific problems and introduce potential risks that may not yet be on your radar.**

The primary authors are Dave Ingram and Max Rudolph. In this issue we add David Ensor as a guest author. We are active participants in the risk management, actuarial, investment and insurance spaces, and have been for many years.

Subscribers can suggest topics for articles and ask questions of the authors during our follow-up webinars and discussion sessions. Ever cognizant of regulatory requirements, leveraging them to add value to your company in practical ways will be our focus.

Published by Actuarial Risk Management (ARM), the Strategic and Risk Solutions for Executives (SRSE) subscription will consist of two paid tiers. The newsletter is free to all.

A webcast is available at either the company or individual level, as well as a follow-up one-on-one discussion with the newsletter authors that extends the general webcast. More info can be found at the final page of this newsletter.

We hope you find a solution that works for you!

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**maltschull@actrisk.com**

## We hope you will join us on our journey!

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# Learning from Loss

**A CEO was meeting with their CRO, CFO along with several members of business unit management a few months after the close of a year that included an unexpected loss by that same business unit that reduced reported group income by almost 75%. They asked if there was any good reason that they should continue the business unit that had created the loss with the current management. Of course, a wild melee started with everyone talking at once.**

It was obvious from this chaotic scene that no one had planned for any loss, ever. That is not uncommon. Overconfidence is often highly valued, until it isn't.

When companies first started to add the Chief Risk Officer (CRO) position along with risk departments, there were several functions that they immediately assigned to the CRO. Designing and implementing the new risk management system, risk assessment and reporting, presenting risk and risk management reports to the board are several of the most common responsibilities. Looking backwards and assessing the compliance with and effectiveness of the risk management system is sometimes a part of the CRO's responsibilities and sometimes that role falls to auditors under a "three lines of defense" approach.

But usually that review is not the sort of "failure analysis" needed after a major loss. That regular oversight function is often too gentle to produce the kinds of information to answer the natural question that the CEO asked above, basically should he terminate just the management, should he just close the business, or is there something salvageable here?

This sort of investigation could be assigned to the CRO well in advance of any major loss. If that assignment has happened, then the CRO has a good reason to accumulate the sorts of background information that is essential to getting to real insight as to the reason for the loss. That background information basically is the answer to the question: What is it that management of a business unit expects to happen in a seriously adverse situation?

More specifically, here are a dozen questions that the CRO should answer about the business unit and the loss:

1. *Was the strategic risk trajectory for the business unit appropriate for the company's financial situation, the risk environment and the primary strategic objectives of the organization?*

Here, risk trajectory means the choice of either:

- Increasing risk faster than surplus
- Increasing surplus faster than risk
- Balancing the growth of risk and capital.

# Learning from Loss (cont'd)

The wrong choice of risk trajectory may leave a company in too fragile of a situation and therefore more sensitive to losses. Or, the losses might be just the inevitable consequence of being in the risk business.

2. *Did the specific plans of the business unit in the years prior to the loss support the chosen trajectory?*

Companies can make good decisions but execute them poorly. A major loss might result from a bad decision, a good decision and poor execution, or simply bad fortune.

3. *Were the risk appetite and tolerance for the group and limits for the business unit set through a robust process that considered the pertinent factors?*
4. *Was compliance with risk appetite, tolerance and limits monitored regularly?*
5. *Was the company in compliance, especially for the business unit that had the major loss?*
6. *If risks exceeded their limits, were actions taken to get back in compliance?*

The choice of risk appetite, tolerance and limits can have a major impact on risk taking activities, but only if compliance is monitored and if there are real actions taken as a result of breaches or near-breaches. If a company does not have an active appetite/tolerance/limit system, then it is really hard to honestly say that a large loss was outside of expectations.

7. *Did the risk assessment process expect to use the best available methodology?*
8. *Was that methodology actually used?*
9. *Were the risk assessments performed and reported in a timely manner?*

**The best risk management requires the best risk assessments so that actions are taken at the right moment, in the right direction and of the right intensity.** There is often a trade-off between the accuracy and timing of risk assessments. The best number, delivered too late for corrective action, is of little value.

10. *Were the planned mitigations capable of reducing the frequency and/or severity of losses in the manner expected?*

Did you know that a Tier 2 subscription enables everyone at your company to participate in a webinar covering the same topics as you are reading about in this newsletter?



+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730

# Learning from Loss (cont’d)

11. *Were the planned mitigations carried out as expected?*

Mitigations are your defense. If you chose the right mitigations and executed them well, then you would have expected to be safe. And finally:

12. *Did your peers suffer comparable losses?*

There are several parts to the answer to that one, like were they similarly exposed and did they use the same mitigations to similar effect (or lack thereof).

If there was a flaw in your approach to this risk that resulted in the major loss, these 12 questions ought to help find it for you. And if the CRO can lead the company through the process of answering these questions and finding that flaw, then management will be able to continue with the intended strategy and corrections as needed, rather than abruptly fleeing their strategy and seeking some other path.

**For more information about how the authors can help with various Enterprise Risk Management (ERM) Services please visit [www.actrisk.com/erm-program-development](www.actrisk.com/erm-program-development)**



+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730